No. 3953

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

J. P. DUKE, as Supervisor of Banks of the State of Washington, and as Successor in Office of the Defendant CLAUDE P. HAY, as State Bank Commissioner of the State of Washington, FORBES P. HASKELL, JR., as special Deputy Supervisor of Banks of the State of Washington, and SCANDINAVIAN AMERICAN BANK OF TACOMA, a Corporation,

Appellants,

vs.

McCLINTIC-MARSHALL COMPANY, a Corporation, FAR WEST CLAY CO., et al.,

Appellees.

REPLY BRIEF OF J. P. DUKE, ETC.

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As we shall specifically point out to the Court, we cannot agree with the statements which purport to be statements of fact, as contained in the brief of the Appellees, Far West Clay Company, et al. Assuming however, that all of the purported facts therein set forth are true, the Court is confronted with this situation, (we italicize the statements which we do not think are supported by the evidence):

The Scandinavian American Bank was the owner of two lots subject to a seventy thousand dollar mortgage, which mortgage was owned by the Penn Mutual Life Insurance Company, *which it was legally obliged to pay*, but which would not be due until September 1, 1920. In February, 1920, it deeded these lots to the Scandinavian American Building Company, *and expressly agreed with the grantee to pay this mortgage when due;* in consideration of which the grantee agreed to deliver to the bank before June 10, 1920, second mortgage bonds of the par value of three hundred and fifty thousand dollars, secured by a mortgage covering the property so deeded. The bonds were not delivered by the grantee and the mortgage was not paid by the bank. The grantee in attempting to build on the property incurred large debts of a lienable nature for which liens were filed against its interest in the real property, after which both the bank and the building company become insolvent.

Under these facts what are the rights:

First, of the holder of the mortgage?

Second, of the creditors of the building company?

Third, of the creditors of the bank?

In the hands of the Penn Mutual Life Insurance Co. this mortgage was superior to all liens. If the bank was personally liable for the debt, the Penn Mutual could enforce its mortgage against the

property and file a claim against the assets of the bank for the deficiency—if any; or, it could waive its mortgage and file its claim as a general creditor of the bank. If it did this, it would be required to surrender its mortgage to the Supervisor for the benefit of all of the creditors of the bank, and the Supervisor would thereupon hold the mortgage for the benefit of all of the creditors of the bank in exactly the same status as it existed in the hands of the Penn Mutual.

If the Supervisor, whether rightfully or wrongfully, believes that it will be for the best interest of the creditors whom he represents for him to buy an assignment of this mortgage and to hold it and assert it for their interests, in what way is the status of affairs changed? In the hands of the Penn Mutual it was prior to the liens; in the hands of the Supervisor it is prior thereto, he having all the rights which the Penn Mutual had.

What rights have the creditors of the building company?—the right to take an assignment of the mortgage and thereby become possessed of the rights of the Penn Mutual, if they so desire. If the bank had agreed with the building company to pay this mortgage—as they assert—could they demand that the Supervisor pay it forthwith? No, because by so doing he would be preferring them to the other creditors of the bank. The Receiver of the building company would be entitled to file a claim with the Supervisor for the breach of the contract,

and the measure of his claim for damages would be the $70,000.00 and interest. If this claim were rejected by the Supervisor he would have to sue to establish it. Now, would any American Court hold, in that event, that the Supervisor would be ordered to allow the Receiver his claim, and that he could not offset as against the claim the building company's breach of the contract by which it obtained title;—or that he could not offset money actually loaned to the building company, totaling nearly $500.000., and evidenced by promissory notes?

The bank being one of the creditors of the building company, the Supervisor, as representing the creditors of the bank and having a claim as such against the receiver of the building company, would have the same right that the other creditors of the building company would have, namely, to take an assignment of the mortgage, and thereby become subrogated to the rights which the Penn Mutual had. Now, is that right taken away from him by reason of the fact—if it be a fact—that the bank had agreed with the building company to pay the mortgage? Certainly not—because even if there were no offset to this obligation, the creditors of the building company could not force the Supervisor to pay it and thus prefer them over the other creditors of the bank.

It seems to us that all of these propositions are elementary. We do not believe that anyone will

contend that in the hands of the Penn Mutual this mortgage could not be enforced and that it would not be superior to all the liens. It is elementary that the assignee or endorsee of a negotiable instrument thereby acquires the rights of the assignor or endorser and if he be entitled to enforce the same, defenses which could not be made as against him, cannot be made against the assignee or endorsee.

The money used to purchase this assignment was a trust fund in the hands of the Supervisor which it was his duty to distribute pro rata to *all* of the creditors of the bank. It was not the money of the bank or of the stockholders of the bank, for under our law the Supervisor does not represent either the bank or its stockholders. Even if the Supervisor desired, would a court of equity permit him to do so manipulate this transaction as to make it a preference, whereby the creditors of the building company, who would be mere general creditors of the bank to the extent of $70,000.00 (if we assume that the bank agreed to pay the mortgage and there was no offset) were paid in full to the detriment of the other general creditors of the bank? We do not believe anyone will contend that the Supervisor has the legal right to prefer one general creditor to another. Yet stripped of all its verbage that is the argument of the appellees— not only that the Supervisor could prefer them, but that he was under a legal obligation to prefer them, and the Court will not permit him to say that he

did not prefer them, but will make him prefer them whether he wills it or no.

And as to the offset to this claim (if we assume that the bank agreed to pay this mortgage) the Supervisor could not legally waive these. He could not have allowed the claim of the receiver of the building company for $70,000.00, when by the terms of the very transaction out of which that claim arose, the building company became indebted to the bank in the sum of $350,000.00, or if, as appellees assert, the $70,000.00 is included in the $350,-000.00 in the sum of $270,000.00. The appellees admit in their brief that the consideration for the agreement of the bank to pay the mortgage was the agreement of the building company to deliver to the bank $350,000.00 of second mortgage bonds. If that be true, we submit it is conclusive, and if, for any reason, legal or equitable, this could not be offset, there were numerous promissory notes aggregating over $200,000.00, which certainly could have been offset. In fact the finding of the District Court was to the effect that the bank had "advanced to and for the benefit of" the building company money aggregating $232,094.42. (Tr. 524-525.) If, therefore, the Supervisor had attempted to allow this claim for $70,000.00 for breach of contract, any person interested in the assets of the bank could have enjoined the Supervisor from paying dividends thereon, and no court with knowledge of the facts would have permitted him to pay

dividends thereon, even if no one objected.

So that, as we view the facts, it makes no difference whether or not this mortgage was the personal obligation of the bank or whether or not the bank did agree with the building company to pay it. In fact, however, it was not the personal obligation of the bank. The Chilbergs, the bank and the Penn Mutual entered into a written contract wherein it is expressly stated that the bank was not liable on the mortgage debt and that the only personal obligation was that of the Chilbergs. (Ex. 327 Tr. at p. 1208-9.) It seems to us, therefore, that it is utter nonsense for the appellees to argue that this mortgage was the personal obligation of the bank, or that if Chilberg had been sued upon this personal obligation he could have claimed: "that it was not his debt, but that it was the debt of the bank," as stated on page 40 of their brief.

It is stated constantly throughout appellees' brief that the bank expressly agreed with the building company to pay this mortgage and that the amount of the mortgage was included in the purchase price. The bank had been carrying these lots at $280,000.00. It had paid Drury $65,000.00 for Lot 10, the adjoining lot, and Drury had conveyed this lot to the building company. This $65,000.00 was not carried as a loan. There was no written obligation in the bank's records anywhere whereby the building company became obligated to repay the bank this $65,000.00, except in the sum

of $350,000.00. These two items total $345,000.00. The building company had four months within which to deliver the bonds, and three months' interest on $345,000.00 would amount to $5,000.00. So that unless the bank was to be repaid this $65,-000.00 by these second mortgage bonds there was nothing anywhere in the bank's records to balance the expenditure of $65,000.00 for the Drury lot. In fact, as we understand it, the appellees concede that this $65,000.00 item was included in the $350,-000.00 purchase money item. (Brief p. 5.) If it was included in the purchase money, it of necessity excluded the $70,000.00, unless the Court is going to believe that this property which the bank was carrying on its books for $270,000.00 was to be sold to the building company for $200,000.00. Added to this, the written contract between the bank and the building company (Ex 184 Tr. 1020-1-1) recites that the property is "encumbered by a mortgage" for $70,000.00, and that the building company proposed to buy the property for $350,000.00. We, therefore, submit that except as an agreement on the part of the bank to pay this mortgage may be impliedly contained in the warranty deed, there is no agreement on the part of the bank to pay the mortgage, and the facts all show that the bank was not to pay it.

Much stress is laid by Appellees on the fact that Larson took a check east in September to pay this mortgage, but persuaded the Penn Mutual to

extend the payment thereof. It is significant, however, that Larson told the mortgagee's officers "that we needed the money *until we could get the money from the Metropolitan.*" (Tr. 1045.) This very clearly corroborates what Larson had just stated, namely, that the $70,000.00 mortgage was to be paid by the building company out of the proceeds of the Metropolitan mortgage. No entry at all of this was made upon the bank's books, so that how Larson would have ordered the bank's clerks to charge it if it had been used, is entirely problematical. In view of Larson's conduct, as shown by the evidence, we submit that the taking of this check shows nothing. Whenever the building company needed money Larson in some way or another, so arranged things that the bank's money became available to the building company. So that the fact that Larson in this instance took the bank's money with which to pay this mortgage, shows nothing.

Appellees state that this building project was a "scheme of the bank"; that the building company was incorporated by the bank, so that the bank might illegally invest an amount equal to its entire capital stock, as thereafter increased, in the building in order to provide permanent quarters for the bank. There is nothing in the evidence directly or indirectly to justify these statements. The evidence conclusively shows that the bank was to have merely a lease of the banking rooms, (Ex 184 Tr. 1022); that the scheme was the scheme of

Larson, who owned practically all of the capital stock of the building company, and that the other directors of the bank consented to the arrangement only upon Larson's assurances that the building company would buy the lots from the bank, erect a building and operate it, and that not one cent of the bank's money would be invested in it.

It is true that Mr. Larson stated that he had Simpson assign the $600,000.00 to the bank because Simpson was ill, but we submit that Larson's own testimony shows this to be untrue, because at the same time he says that Simpson went from Philadelphia to Chicago with him for the purpose of having this assignment drawn, which is nonsense; and his telegrams to Sheldon while in Chicago with Simpson show that Simpson was leaving to go to Massachusets in an endeavor to borrow money on this mortgage. (Ex. 346, Tr. p. 1228.) On the other hand Sheldon, the secretary of the building company and the vice president of the bank, testified that he gave this note and mortgage to Larson for the express and agreed purpose of having an assignment of it made to the bank as its security, (Tr. 1154) and in this he is corroborated by the written evidence. (Ex. 248, Tr. 1155.) Appellees statement that "when or how or with whom this idea originated" is not shown, is, therefore, a mistake, as is also the statement that the building company as such did not consent to it. Sheldon says that this was talked over at that time with Drury, the presi-

dent of the building company; he, the secretary of the building company, delivered the documents and took a receipt therefor, (Ex. 348), and Larson, the owner of nearly all of the stock of the building company, got the assignment.

Appellees say that this would destroy the value of the mortgage for the purpose for which it was given. Why? As we view the evidence this was the very purpose for which the mortgage was given to Simpson. We believe appellees will admit that the mortgage ran to Simpson rather than to the Metropolitan in order that Simpson might use it as a pledge to secure funds pending the completion of the building. Why, then, should the bank be precluded from advancing these funds rather than someone else? The Metropolitan even suggested this in June: "with our committment and our mortgage of record, I should think you could arrange to finance the matter with your own funds". (Ex. 214, Tr. 1080.) While it is true that at the time the mortgage was executed it was not intended that the mortgage should be assigned to the bank or that the bank should advance money on it, it is equally true that the persons to whom it was to be assigned and who were to advance money were not known. If, for instance, Strauss & Company had advanced $600,000.00 and taken an assignment of this mortgage in July or August as the evidence shows Simpson was endeavoring to get them to do, we believe no one would contend

that the mortgage was invalid and was not prior to the lien,—by what process of reasoning does it become invalid in the hands of the bank which did the same thing?

Appellees statements of the facts throughout their brief are inconsistent with themselves. They state that it was the failure of the bank to pay the $70,000.00 which caused the building company to breach its agreement to deliver the second mortgage bonds, and that by mutual consent the bond issue was abandoned, yet they claim that the bank's advances were to be paid out of the bond issue. Probably the evidence would warrant the inference that the two $25,000.00 loans of March and April, 1920, were expected to be paid out of the bond issue, because it was in February or early March that Simpson told these people that he had the entire bond issue placed and that the money thereon would be fothcoming as soon as the bonds were executed and delivered. (Tr. 1018.) But as early as June 5th Larson knew this was untrue because he was then attempting to get the Metropolitan to make advances on the $600,000.00 mortgage.

Appellees state their objections to the $70,000.00 under four heads.

(1) That the debt secured thereby was in form Chilberg's debt, but in fact the debt of the bank, "and the bank was under a legal obligation to pay it".

This contention is entirely answered by the written contract of all of the parties, which has not been attacked for fraud or mistake (Ex 327, Tr. 1204) which provides:

"It being understood, however, that the Scan-
"dinavian American Bank of Tacoma does not
"itself assume any personal obligation to pay the
"indebtness secured by the mortgage, the only per-
"sonal obligation to pay said mortgage being the
"personal obligation of J. E. Chilberg and Anna
"Chilberg, his wife."

This contract is signed by the Chilbergs, by the bank and by the Penn Mutual, under the seal of the two corporations, was acknowledged before notaries public and placed of record with the Auditor of Pierce County, Washington, in 1915.

On practically every page of their brief the appellees make the statement that the bank expressly agreed to pay the $70,000.00 mortgage. No attempt is made to point out the instrument in which this express agreement is embodied, and we submit with confidence that there is no such instrument in the record. Appellees evidently believe that constant repetition of this assertion may lead the Court to accept it as a conceded fact. We will not attempt to match appellees by making an equal number of statements to the effect that this is not true. It may be that there was an implied agreement to this effect because the lots were con-

veyed by warranty deed, but that is by virtue of the fact that the legislature has seen fit to enact that the use of the words "grant and convey" in a conveyance impliedly means that the grantor warrants against encumbrances. In this case, however, the very contract whereby the bank agreed to convey the property to the building company "by warranty deed" recites that the property was encumbered by the $70,000.00 mortgage and that the building company had offered $350,000.00 for it, and the facts show that the building company would owe the bank the $350,000.00 for this property and the Drury lot by the time the building company was to make the payment.

(2) The second proposition is that when the lots were sold the $70,000.00 mortgage was added to the purchase price and included in it and that the bank having expressly agreed to pay the mortgage "*the bank and hence Duke*" could not pay it and hold it "*against the intervening rights and equities of others.*"

In other words, the owner of a piece of property worth $350,000.00, encumbered by a $70,000.00 mortgage due in six months, who conveys the property to a grantee and agrees to pay the mortgage, in consideration of which the grantee agrees to pay $350,000.00 in four months, could not take an assignment of the mortgage after it became due and after the grantee had defaulted in its

contract to pay for the conveyance of the property. It seems to us that the bare statement of these facts is a complete answer to this contention. That under such circumstances no one should contend that the mortgage as between the grantor and grantee could not be enforced. What greater "intervening rights and equities" would the creditors of the building company have than the building company itself would have? This mortgage was of record at all times and it is elementary that the lien of the lienor is against the right, title and interest of the owner, and that he can have no greater estate than the owner has.

The argument seems to be advanced that the lienors were entitled to rely on the bank's warranty deed and thus are in a position to defeat the mortgage in the hands of the Supervisor. This is certainly a novelty. It would mean that a man who contracted with an owner to furnish lumber thereby acquired greater rights in the land than the owner had. This, of course, is not the law, but is contrary to all law.

Let us assume, however, that had the bank paid this mortgage when it became due and taken an assignment of it, while the bank was a going concern and solvent, and that under these circumstances the creditors of the building company by reason of some alleged equities would have been entitled to have the same cancelled of record as against the bank, we will admit that if these facts

be assumed, and the bank then became insolvent, the title to this mortgage vesting in the Supervisor by operation of law, would, in his hands, be subject to all valid, existing, outstanding, legal and equitable rights, and that the Supervisor could not enforce it. Appellees cite many cases to this effect. That is the law, we have never questioned it. But this does not apply to the facts of this case. The bank never had any title to this mortgage. The Supervisor acquired it, not by operation of law and by virtue of his office, but by the payment to the Penn Mutual of $70,000.00 in cash out of trust funds in his hands. The money that he used belonged not to the bank, or the stockholders of the bank, but was a trust fund in his hands for the benefit of the creditors of the bank. And even if we assume that the creditors of the building company were the creditors of the bank, this fund did not belong to that one class of creditors but to *all the creditors of the bank.* If, therefore, *after his appointment*, he converts this trust fund from the form of cash in his hands into the form of an obligation to pay money, he is entitled to assert it for the benefit of *all the creditors of the bank*, and would not be permitted by the courts to apply it so as to prefer one class of general creditors to another class of general creditors.

(3) Appellees' third propositon is that because of the warranty deed "*the bank and hence Duke*" could not assert the mortgage "*in violation of the*

warranty against intervening rights and equities". This is the same as appellees' second proposition except that the implied agreement to pay the mortgage is the reason advanced rather than the alleged express agreement to pay it.

In this connection, however, the appellees state that had Duke not paid the mortgage "and if, by reason of its foreclosure the building company lost its property, it would have a claim against the bank for damages "*in a very large sum.*" We wonder when the law of damages was changed, and the measure of damages for breach of a convenant against encumbrances became the value of the property plus "intervening rights and equities".

This suggests a very pertinent query—(assuming that the bank's warranty deed was not intended by both parties merely to convey the bank's equity in the property, as we contend) how can the warranty deed be construed into a covenant or agreement to pay the mortgage? This warranty was breached the moment the deed was delivered. At that moment the building company had a cause of action against the bank for the breach, and did not have to wait until the mortgage was due or an attempt made to foreclose it, unless there was some agreement express or implied with regard thereto. The facts conclusively show that this was not the intention. Both the bank and the building company knew of this mortgage. It was mentioned in the very agreement whereby the bank

agreed to give the deed. Had the building company sued for this breach, it would, therefore, have taken only very slight circumstances for the court to have held that this warranty was a mutual mistake and that the building company took subject to the mortgage. Besides Larson's testimony that the money to pay this mortgage was to be taken from the Metropolitan mortgage by the building company, we have the circumstance that the amount the building company agreed to pay was merely the value of the land, *subject to the mortgage*, plus the cost price of the Drury lot, and the further circumstance that the building company had four months within which to pay, and even then was not compelled to pay in cash, but in second mortgage bonds.

(4) Appellees' fourth proposition is that the \$70,000.00 is included in the \$350,000.00, which the building company agreed to pay for this property, that we have asserted both the \$70,000.00 and the \$350,000.00 claim, and that we are, therefore, affirming the contract and repudiating it at the same time. We cannot follow this reasoning. If the contract whereby the building company agreed to pay \$350,000.00 for the property contained a clause that the bank would pay the mortgage, this fourth proposition might be founded on the facts. The weakness of this proposition is that the contract (and no other contract for that matter) contained no such agreement. Even it there were a contemporaneous or subsequent oral agreement

to this effect, or another written contract to that effect, this agreement or contract would merely be a defense *pro tanto* to the $350,000.00 claim.

As we have said, however, the facts conclusively show that this $70,000.00 mortgage was not included in the $350,000.00 consideration. As we see it the appellees virtually admit this when they state that the $350,000.00 included the Drury lot, which it did. There is no question but that the bank valued its equity in the property at $270,000.00. That is the value at which it was carried on its books and reports.

Appellees then regail the court with their conception of the reasons actuating the Supervisor when he bought the assignment of the mortgage, one of which is that we have mentioned, namely, that if he did not pay it, and it was foreclosed, the estate in his hands would have become liable for "damages in a very large sum".

We think the Supervisor's reasons are disclosed by the record. He had in his hands a $600,000.00 mortgage—all of the records of the bank showed that this was held as collateral security for debts due from the building company totaling nearly $750,000.00; and if this Court holds that that mortgage is not security for these debts, it will be by virtue of the oral testimony of Larson, disputed by the oral testimony of every other officer and clerk of the bank, and by the written records of the bank,

some of which were made by Larson himself. He, therefore, bought this $70,000.00 mortgage to prevent its assertion as against the $600,000.00 mortgage, to prevent the collection of 12% interest on it, as its terms provided, and to save the costs as far as the $600,000.00 mortgage and the estate in his hands, were concerned. There was nothing indirect or hidden in these motives. They were stated in his petition to the court as noted by the appellees in their brief at page 11. There is, therefore, absolutely, no foundation for the argument that Duke bought it to prevent the creditors of the building company from collecting large damages, and with the idea of discharging it, and that its foreclosure was an afterthought.

Appellees cite portions of the opinon in *Sisk vs. Rapuano*, 11 A L R, 1291, as authority. If the words of the opinion which are cited were used with respect to facts in anywise analogous to the facts of this case, they might be considered some authority, but they were not. In that case the trustee did not use money in his hands to buy the mortgage, but attempted to change an agreement made between the bankrupt and the mortgagee before the adjudication, wherein certain insurance money *was applied by the bankrupt and the mortgagee to the satisfaction of the mortgage*, and to keep the mortgage alive notwithstanding this agreement, application and payment. Quite rightly the court held that he could not do this. The court

says, referring to the contentions that the intention of the parties must prevail, that the intention was to keep the note and mortgage alive, and that the parties, not the court, had the right to apply the insurance money and had done so, (italics ours):

"These propositions *assume that the trustee and* "*the mortgage were free to deal* with the insurance "money as they saw fit, and might make such "application of it as they chose; whereas, the defend-"ants claimed and the court so rules that, by the "terms of the policy, the insurance money, or so "much of it as was necessary for that purpose, had "*already been applied*, or agreed to be applied in "case of loss, *to the payment of the mortgage* * * *. "In this case, however, the mortgage debt was due "when the insurance was paid * * * it will, "therefore be apparent that if Miss Bowler (the "mortgagee) had received her agreed share of the "insurance money directly from the insurance "company after the debt was due, she would be "bound to apply it to the extinguishment of the "mortgage * * *. In this case the contract of "the insurance company to pay the mortgage was "for the benefit of Grillo (the bankrupt mortgagor) "and for the purpose of entingushing his liability "on the note and of releasing his land from the "encumbrance of the mortgage. After the loss, "and before it had been adjusted, Grillo conveyed "the land to Ruby by warranty deed free from "all encumbrances, and undertook to apply the insur-

"ance money in payment of the mortgage debt. "He thus remained liable on the note and on the "warranty, and had the same interest as before "in requiring the insurance company to carry out "its agreement so as to extinguish the debt and "release the land."

(The court had previously pointed out that the insurance company by its contract had agreed to pay the loss, if any, to the mortgagee as her interest might appear, and that the insurance company could not change this contract without the consent of Grillo.) The court then goes on to say:

"The appointment of the trustee in bankruptcy "did not release the insurance company from its "agreement with Grillo and if the transaction "recited in the findings amounted in substance and "effect to a performance of the open mortgage "clause by the company, and the acceptance of the "fund by the mortgagee, the mortgage debt was "extinguished in the manner contracted for by the "policy."

The court held this to be true, that the transaction amounted to a payment by the insurance company of the mortgage debt pursuant to its contract agreement with the insured and an acceptance thereof as payment by the mortgage. Naturally the attempt of the trustee to change this agreement and alter these facts could not be sanctioned.

The facts in this case are entirely dissimilar.

There was no agreement of a third party with the bank to pay this mortgage; there was no application of any money by the bank to the payment of the mortgage, and no agreement on the part of the Penn Mutual to accept any particular fund and apply it to the payment of the mortgage; there was no attempt on the part of the Supervisor to change any agreement made between the bank and the Penn Mutual and any other party. With repect to the money that the Supervisor paid for this assignment, the Supervisor was absolutely free to deal with it as he chose, at least in so far as the payment of the Penn Mutual mortgage is concerned, and the Penn Mutual was under no obligation to apply the Supervisor's money to the payment and extinguishment of the debt, but was free to deal with the money and the mortgage as it saw fit.

Appellees then advance what seems to us to be a wierd proposition, to the effect that even though the building company could not have defended against the mortgage in the hands of the bank, that nevertheless the creditors of the building company could, because they could rely on that part of the record which showed the warranty deed and ignore that that part of the record which showed the mortgage. This is at variance with the holding of the Court, particularly the Washington court, which has held time and time again that the record is notice to all the world. In the case of

University State Bank vs. Steeves, 85 Wn, 55, it is said:

"The mortgage was of record in the auditor's "office and unsatisfied of record. This of itself is, "in any event, sufficient to bind those who became "interested in the property subsequent to the execu- "tion and recording of the mortgage."

Appellees also assert that *"the bank"* made false representations which induced them to make these contracts. These representations were to the effect that the $600,000.00 mortgage had been arranged for with the Metropolitan, and that the right to lien had to be waived so as not to interfere with the mortgage, and that there would be $400,000.00 available to begin the work. Even if these representations were made *"by the bank"* the bank made them good and to spare, having advanced a total of $443,000.00 in cash to the building company. (Ex. 348, Tr. 1235.) So that these representations could have no effect on the rights of the Supervisor with respect to the $70,000.00 mortgage. But these representations were not made by the bank. The evidence showed that they were made by Drury, Larson Webber and Simpson, in Webber's office in the Tacoma Hotel, which was then the headquarters of the building company, when the contractors were entering into written contracts with the building company. (Tr. 1115-16.) Neither Simpson or Webber had any connection whatever with the bank. Drury and Larson, although officers of the

bank, were the president and principal stockholder respectively of the building company.

In this connection the court will notice that the lien claimants in their briefs herein attribute to the bank as a corporate entity the intentions, motives and acts of Larson and Drury, even though the evidence shows that at the very time they were engaged in the conduct of the business of the building company, or even engaged in the business of the looting of the bank for their own private profit, or for the profit of the building company. So that it will not just for the court to accept their statements as to what the bank did or intended without investigation. Usually the court will find that it was something that Larson did or intended, and Larson was then engaged in the perpetration of a fraud on the bank.

We do not question the rule to the effect that one who is under a legal obligation to pay a mortgage cannot pay it, take an assignment of it, and then enforce it to the disadvantage of anyone to whom his obligation to pay extended, but this rule is subject to the exception that he can enforce it against anyone to whom his obligation to pay does not run. For instance, if A buys property encumbered by a mortgage which he assumes and agrees to pay and is thereafter ousted by B by virtue of some superior title, A would have the right to fulfill his contract by buying the mortgage, could take an assignment of it and foreclose it as against B, or

anyone claiming under B, because he was under no obligation as for as B was concerned to pay the mortgage. So in this case, at least, while the building company was in default in its agreement to pay the bank for the land, the bank was under no obligation to pay the mortgage, and if it was obliged to pay it, it could take an assignment of it and foreclose against the building company, and any one claiming under the building company.

But the appellees would have the court go even further than this, because even if we assume that in this case the bank was legally obligated to pay the mortgage, the Supervisor was not only under no obligation to pay it, *but was under a legal obligation not to pay it,* if thereby he preferred one class of general creditors to the rest of the general creditors of the bank.

Nor do we dispute the general principle of law that one who has been paid the full purchase price for his land and conveys it by warranty deed cannot thereafter purchase and outstanding title or mortgage and assert it as against his grantee or anyone claiming under his grantee. But if the grantor as trustee bought the outstanding title or mortgage with trust funds for the use and benefit of the *cestui,* as such trustee he could enforce it even against his grantee. In such capacity he would be a stranger to his grantee. So that in this case even though the bank could not have bought up and enforced this mortgage, the Super-

visor as a trustee for the creditors of the bank having purchased the mortgage with trust funds could enforce it.

Besides this, we submit that no court has ever held or ever will hold that a grantor who has been induced to convey away his land by warranty deed and who has expressly assumed to pay an outstanding encumbrance, in consideration of the agreement of the vendee to pay him at some future time, may not take an assignment thereof and enforce it even against his grantee after the default of his grantee.

Notwithstanding the refusal of the appellees to recognize the distinction between the title acquired by the Supervisor from the bank by operation of law, which we admit to be nothing more or less than the bank's title subject to all outstanding rights, and the title acquired by the Supervisor as a trustee when he uses the trust funds to purchase property for the benefit of the *cestui*, we believe that the court will recognize that there is very great difference. We also believe that the court will have no difficulty in distinguishing the difference between a receiver of an insolvent corporation who represents not only its creditors, but the corporation and its stockholders as well, and the Supervisor who represents only the creditors and who does not represent the bank or its stockholders.

We believe that we have already answered the somewhat lengthy argument of appellees to the

effect that we are attempting to enforce the contract whereby the building company agreed to give the bank $350,000.00 of second mortgage bonds, and to repudiate that contract at the same time. We recognize the rule which prohibits this, as the law. This contract, however, contains no provision whereby the bank agreed to pay this $70,000.00. As a matter of fact we believe that this court will agree with us that as between the bank and the building company this $70,000.00 mortgage was to be paid by the building company and that the failure to incorporate an exception of this $70,000.00 mortgage in the warranty deed was a mere oversight; but be that as it may, if the bank did agree to pay this mortgage in consideration of the building company's engagement to pay the bank $350,000.00, it was by virtue of the warranty implied by the use of the warranty deed or some oral agreement. We are, therefore, not attempting to enforce and repudiate the same agreement. And, as we see it, even if appellee's contentions be true, the only effect of such an agreement would be to reduce the amount of our recovery from $350,000.00 to $280,000.00. As illustrative of the legal proposition to which we have called attention, we cite the Court to the following cases in addition to those cited in our opening brief:

Greenwell, Admr. vs. Heritage, 70 Mo., 459
Begein vs. Brehm, 23 N. E., 496
Arnold vs. Green, 23 N. E., 1

Howard vs. Robbins, 63 N. E., 350
University State Bank vs. Ellison, 85 Wn., 55; 147 Pac. 645; and 2 A. L. R., 237 where the same is extensively annotated.
Wood vs. Smith, 51 Iowa, 156; 50 N. W., 581

The $600,000.00 Mortgage

In considering this case, the Court will bear in mind that it is really a contest between creditors for priority. One class of creditors, the lien claimants, asserting that they are entitled to priority in the insolvent estate, as against another creditor, the Supervisor, who in turn represents the creditors of the bank, which was a creditor of the building company. If they were all simple creditors, the maxim "equality of equity" would apply. By virtue of the fact that they are creditors, therefore, they stand on an equal footing, and neither has any equity superior to the other. They all gave credit to the building company. If there is any priority between the lien claimants it is by virtue of the Statute and not by virtue of any inherent equity in their position. On the other hand if the Supervisor is prior to them it is because of the Statute and the rules of law surrounding the mortgage.

Prima facie the lien claimants are inferior to the mortgage because it was of record, apparently valid, at the time they lent their credit; and they

had actual knowledge of the fact that it was to be placed of record and would be superior to their claims of lien at the time they made their contracts; and they furnished their material on the assumption that the mortgage was superior to any right they could acquire.

To overcome this *prima facie* inferiority they assert that the mortgage was invalid.

It is said that there was no consideration for its execution, but, we submit, this is obviously not a tenable position. It covers three lots which were deeded to the mortgagor *in consideration of the agreement of the mortgagor to issue this mortgage;* the consideration for the deed was (among others) the mortgagor's agreement to erect a building on the lots and rent a portion of the building to the bank, the grantor, and "for the purpose of financing the erection and construction of said building" the grantee agreed to execute and deliver this mortgage before any actual construction should begin. (Ex 184.) If there was a valid consideration for the mortgage, then another objection, namely, that it contravened the Constitution of Washington is untenable. And one of the principal reasons why the Metropolitan was willing to loan on the mortgage was the agreement of the bank to rent the banking room from the building company. That there was a consideration for it is too plain for argument.

It is said it was not used for the purpose for which it was executed. What was its purpose? Obviously to borrow money. Can the mortgagor, or anyone claiming under the mortgagor, claim that it was invalid because the money was paid to the mortgagor before the time it was intended to be paid when the mortgage was executed? At the time the mortgage was executed and placed of record, it was made to run to Simpson rather than to the Metropolitan for the very purpose of using it "as collateral for money borrowed during the construction." (Ex. 222, Tr. 1093-0.)

It is said it was paid by the bank which did not intend to lend at the time it was executed. What of that, if it was actually paid to and received by the mortgagor.

It is said that the mortgagor did not know that the bank had taken an assignment of it and was advancing the money on the strength of it. This is a question of fact. Drury, the president of the mortgagor, knew it, and suggested that it be assigned to the bank to protect its interest to Sheldon, the secretary of the mortgagor, (tr 1154,) who thereafter delivered it to Larson, the man who owned all of the stock, who said he was taking it to "have a proper assignment drawn up in favor of the bank, for the reason that the bank had advanced certain moneys and would have to advance some more, and this assignment was taken for the protection of the bank." (Tr 1161-62.)

It is also contended that it was not "delivered" or did not "attach" prior to the time the materialmen began to "furnish" their material. It is delivered and "attaches" when it is placed of record, pursuant to a valid agreement and passes beyond the control of the mortgagor.

It was placed of record, there is no controversy over that.

This was done pursuant to a written contract supported by a valid consideration. Although this is controverted, it is because appellees have overlooked the terms of the written contract whereby the building company agreed to erect the building, and for that purpose to execute and record this particular mortgage "before actual construction shall begin, and before any contract for such contruction shall have been let." The word "execute" purports a valid delivery, an instrument is not executed which is not delivered. In view of this contract, it can scarcely be argued that both the bank and the building company did not intend that upon the delivery to Simpson and its record with the Auditor, it should become a valid lien against the title of the building company to the lots in question. The contractors had both actual and constructive notice of it and deliberately waived their liens in order that no question as to its priority could be raised. Had the building company refused to execute it, the bank would have had a cause of action for damages for breach of this contract. Under the

circumstances of this case we feel sure that no court would hold the building company in this respect had not fulfilled this covenant and that the bank could have maintained an action thereon for its breach. If this be true it was delivered and attached at the time of its record. The question as to when it attached is really settled by the Lien Statute itself. The question of law as to whether once attached it is security for future advances made on the strenght thereof, is settled by the cases cited in our opening brief.

As to whether these advances were made on the credit of the mortgage: we assert that they were; appellees assert that they were not. It is true that Larson said that they were not, but in the very sentence in which he says that they were not, he shows that that was the intention. He says (Tr 1085) after refusing to answer various questions because he had been arrested 36 times and was not going to be arrested the thirty-seventh:

"I expected simply to use the $600,000.00 second "mortgage for the purpose of making this tempor- "ary loan of $300,000.00 or "$400,000.00, it was "to be used as collateral, there is no question about "that at all. The $600,000.00 mortgage assign- "ment was not taken with any idea of security or "preference whatever and when I got back on "October 17th, I told the Bank Commissioner *we* "would have to carry this building to completion "before *we* could get the money from the Metro-

"politan."

Again he says (Tr 1049):

"When we ran into this delay and all that "trouble came, the mortgage was sent to Philadel-"phia and Mr. Simpson put it in the Prudential "Insurance Company to get a temporary loan of "$400,000.00 on it to go to pay the bills that we "had never expected to pay until the building was "finished. *That was the reason we bought the "mortgage* in, and that was the reason the mortgage "was in Philadelphia * * * ."

The evidence shows that after it was assigned to the bank, the bank loaned the building company $200,000.00 upon notes which were carried as loans secured by real estate and referred to a docket case which contained the note, mortgage and assignment. (Ex 185 Tr 1026; Ex 188 Tr 1030; Ex 336, Tr 1218.) Besides this there were various interest charges represented by a check of the building company which Larson ordered held as a real estate loan until an advance was secured upon the mortgage (Ex 188, Tr. 1030), and an overdraft of $32,746.42 when the bank failed.

There remains only $200,000,00 stock transaction to be considered. Larson subscribed for the stock of the building company, representing to the other officers of the bank that he had it placed or a place for it. On June 5, 1920, the Simpson note

and mortgage were in the bank and Larson wrote to the Metropolitan trying to get them to make an advance on it. On June 11, 1920, they replied, refusing to make the advance, but suggesting that the bank might do so *on the strength of their mortgage.* On June 25, 1920, Larson wrote out a deposit slip indicating that the building company had deposited $200,000.00 in the bank, to which he attached a note directing the clerks to credit the building company with that amount, and to charge account No. 13, stocks and securities, with the notation, subscription to the capital stock Scandinavian American Building Company. On June 28th he left a note with Sheldon requesting him to hold the note and mortgage until an advance could be obtained on it. In September he took the note and mortgage from Sheldon, giving him a receipt therefor, for the purpose of getting an assignment from Simpson to the bank as security. On October 7th he got the assignment. Thereafter the advances were made and in December he directed the clerks to charge the building company interest on the $200,000.00 stock transaction. While it is true that the evidence of an intention to lend this money on the strength of this mortgage is much weaker than the other loans, nevertheless we submit that this does show an intention so to do. The intention of the bank in that respect must have been the intention of Larson at the time he made these entries, since none of the other officers of the bank knew anything whatever about it, with the excep-

tion of Sheldon, who looked it up a few days thereafter to find out how it was that the building company had gotten this credit.

Some of the materialmen claim that this was a sale and that thereby the bank became the owner of the stock. It was obviously no sale, the bank could not be made to purchase this stock without its knowledge or consent. Besides this the books of the building company show that this deposit was made by O. S. Larson.

If it was not a loan on the strength of this mortgage it at least constitutes a simple claim against the building company for the money had and received.

Respectfully submitted,

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